

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

BYBEE FARMS, LLC, et al.,
Plaintiffs,

v.

SNAKE RIVER SUGAR COMPANY, et
al.,
Defendants.

No. CV-06-5007-FVS

TENTATIVE CONCLUSIONS RE
DEFENDANTS' COUNTERCLAIMS
AND PLAINTIFFS' FOURTH
CLAIM

THIS MATTER comes before the Court based upon cross motions for summary judgment. The plaintiffs are represented by Thomas Banducci; the defendants by J. Walter Sinclair. The following are the Court's tentative conclusions regarding the defendants' counterclaims and the plaintiffs' fourth claim.

BACKGROUND

The Snake River Sugar Company ("SRSC") is an agricultural cooperative that is organized under the laws of the State of Oregon. Article III of the Second Amended and Restated Articles of Incorporation (hereinafter "Articles") lists the Cooperative's purposes and powers:

Section 1. Purposes. The purposes of this Cooperative shall be to receive, handle, manufacture, process, and market the sugarbeets and other agricultural products of its members and other producers; to purchase, handle, and distribute agricultural supplies and equipment to its members and other patrons; to perform any and all related services for its members and other patrons; and to engage in

1 any other lawful purpose. This Cooperative shall be
 2 operated on a cooperative basis for the mutual benefit of
 its members and patrons.

3 Section 2. Powers. This Cooperative shall have all the
 4 powers, privileges and rights conferred on cooperative
 corporations by the laws of the State of Oregon, including
 5 without limitation all powers necessary or convenient to
 effect any or all of the purposes for which this Cooperative
 6 is organized.

7 (Article III, §§ 1,2, p. 1.)

8 Each of the three plaintiffs -- Bybee Farms LLC, Duane Munn &
 9 Sons Farms LLC, and Neal Bybee -- owns one share of the Cooperative's
 10 Common Stock and multiple shares of its Patron Preferred Stock. The
 11 plaintiffs paid \$400 per share of Patron Preferred Stock. Under
 12 Article IV, ownership of patron preferred stock confers both a right
 and a responsibility to produce sugarbeets:

13 Section 3. Patron Preferred Stock.

14

15 Paragraph 2. *Rights*.

16

17 (b) Delivery Rights or Quota. The holders of Patron
 18 Preferred Stock shall be entitled and obligated to deliver
 the sugarbeets from one (1) acre of land per share of Patron
 19 Preferred Stock held in accordance with the rules and
 regulations established by the Board of Directors governing
 delivery rights and quota as exists from time to time.

20 (Article IV, § 3, ¶ 2(b), p. 3.)

21 Each plaintiff has executed a Grower Agreement. Like the
 22 articles, it confers both a right and a responsibility to grow and
 deliver sugarbeets:

23 1. Delivery of Sugarbeets. The Grower owns and has the
 24 growing rights to shares of Patron Preferred Stock of the
 Cooperative (here-in [sic] called "Quota") as reflected on
 25 the records of the Cooperative. Grower recognizes such
 26 Quota as the right and obligation to grow, or cause to be
 grown, one (1) acre of sugarbeets per share for deliver to

1 the Cooperative each crop year.

2 (Grower Agreement at 1.)

3 The Grower Agreement establishes penalties in the event a member
4 does not fulfill his contractual obligations. Should he fail to
5 deliver his quota of sugarbeets, he must compensate the SRSC:

6 7. Failure to Plant, Replant or Deliver Sugarbeets. In
7 the event Grower does not meet any of the obligations
8 specified in paragraph 5, and such failure is not excused as
9 provided by Paragraph 6, Grower agrees to pay to the
10 Cooperative a cash sum based upon the LLC's most current
11 projection of the resulting decrease in the LLC's
12 distributable cash as defined in the LLC's Company
13 Agreement, computed on a per acre basis ("Distributable Cash
14 Per Acre Decrease"). **In the event Grower has failed to
15 plant or deliver all or any portion of the Grower's full
16 Quota, the Grower will pay to the Cooperative 100% of the
17 Distributable Cash Per Acre Decrease for each acre which was
18 not planted or delivered.** In the event Grower initially
19 planted, but failed to replant all or any portion of
20 Grower's full quota, the Grower will pay to the Cooperative
21 80% of the Distributable Cash Per Acre Decrease for each
22 acre which was not replanted. **Grower recognizes that the
23 Cooperative and its members will suffer damages from lost
24 production, that such amount is difficult to ascertain with
25 certainty, and that the above formula is a fair and
26 reasonable method to determine damages.**

Id. at 2 (emphasis added). The parties typically refer to the above-
described penalty as a "make-whole payment." Should a delinquent
grower fail to submit his make-whole payment, he forfeits his shares
of Patron Preferred Stock:

8. Agreement to Pay Distributable Cash Per Acre
Decrease or the Reversion of Shares. Grower agrees to pay
the Cooperative the Distributable Cash Per Acre Decrease
owing to the Cooperative pursuant to Paragraph 7 within 90
days after Grower's Paragraph 7 failure, but no later than
the February 1 following such failure, and to take all
reasonable steps to pay such amount, including the sale of
Patron Preferred Stock. **In the event Grower does not pay**

1 **the Distributable Cash Per Acre Decrease within said time**
2 **period, Grower agrees that Grower's Patron Preferred Stock**
3 **in an amount equivalent to the number of acres to which said**
4 **payment failure applies shall immediately revert and**
5 **transfer to the Cooperative without any further action of**
6 **Grower.** The Cooperative agrees to accept the reverted
7 shares as consideration for the discharge of the unpaid
8 Distributable Cash Per Acre Decrease and Grower agrees that
9 such consideration is fair and reasonable.

10 *Id.* (emphasis added).

11 In the United States, the production of sugar is regulated by the
12 federal government. By the end of 2003, the SRSC was producing more
13 sugarbeets than its sister company, The Amalgamated Sugar Company
14 ("TASCO"), could process and sell profitably. Consequently, the
15 SRSC's Board of Directors decided to reduce the number of acres of
16 sugarbeets that each grower could plant. During 2004, the Board
17 imposed a 5% reduction. During 2005, the Board imposed a 16%
18 reduction. Individual growers were not asked to approve the
19 reductions. As a practical matter, the reductions meant that the
20 Cooperative did not allow growers to "deliver the sugarbeets from one
21 (1) acre of land per share of Patron Preferred Stock" during either
22 2004 or 2005. Instead, during 2004, the Cooperative allowed them to
23 deliver the sugarbeets from approximately .95 acre of land per share
24 of Patron Preferred Stock. During 2005, the Cooperative allowed them
25 to deliver the sugarbeets from approximately .84 acre of land per
26 share.

27 As explained in more detail elsewhere, the plaintiffs did not
28 plant sugarbeets during 2005 and 2006. Relying upon paragraph 7 of
29 the Grower Agreement, the Board demanded payment of \$75.00 for each
30 acre of land that the plaintiffs failed to plant. When they did not

1 submit the make-whole payments demanded by the Board, it forfeited
2 their shares of Patron Preferred Stock pursuant to paragraph 8.

3 **DEFENDANTS' COUNTERCLAIMS**

4 The defendants have filed counterclaims against both Bybee Farms
5 LLC and Duane Munn & Sons Farms LLC. The defendants seek declaratory
6 judgments upholding the forfeiture of their shares of Patron Preferred
7 Stock. The plaintiffs move for summary judgment.

8 A. Authority to Impose Reductions

9 The Articles arguably guarantee each member of the SRSC the right
10 to "deliver the sugarbeets from one (1) acre of land per share of
11 Patron Preferred Stock[.]" (Article IV, § 3, ¶ 2(b), p. 3.¹) During
12 both 2004 and 2005, the Board unilaterally limited the number of acres
13 of sugarbeets that the SRSC's members could plant. The plaintiffs
14 argue that the acreage reductions imposed by the Board were ultra
15 vires. Under the laws of the States of Washington, Oregon, and Idaho,
16 a shareholder may seek to enjoin an ultra vires corporate action. RCW
17 23B.03.040; ORS 60.084; I.C. § 30-1-304.² However, the plaintiffs are

18 ¹Paragraph 2(b) states, "The holders of Patron Preferred
19 Stock shall be entitled . . . to deliver the sugarbeets from one
20 (1) acre of land per share of Patron Preferred Stock held in
21 accordance with the rules and regulations established by the
22 Board of Directors **governing delivery rights and quota as exists
23 from time to time.**" (Emphasis added.) The last clause of
24 paragraph 2(b) seems to suggest that the one-acre-of-land-per-
share provision is not inflexible; that the Board is authorized
to adopt rules modifying "delivery rights and quota[.]"

25 ²All three states have adopted the same section of the
26 Revised Model Business Corporation Act. Since all three statutes
are substantially the same, local law applies. *Erwin v. Cotter
Health Centers*, 161 Wn.2d 676, 692, 167 P.3d 1112 (2007).

1 not seeking to enjoin the Board's allegedly ultra vires acreage-
 2 reduction decisions of 2004 and 2005. They are seeking to prevent the
 3 SRSC from invoking paragraph 8 of the Grower Agreement. Even assuming
 4 the Board's acreage reductions were ultra vires, the SRSC clearly is
 5 authorized to enforce Grower Agreements. (Article III, § 2, p. 1.)
 6 Thus, the act that the plaintiffs seek to prevent is not ultra vires.
 7 The plaintiffs' are not entitled to summary judgment on this issue.³

8 B. Antecedent Breaches

9 The plaintiffs allege that the SRSC breached the relevant Grower
 10 Agreements by unilaterally reducing production of sugarbeets during
 11 2004 and 2005. According to the plaintiffs, the Board's decisions
 12 infringed their contractual right to grow "one (1) acre of sugarbeets
 13 per share [of Patron Preferred Stock]." (Grower Agreement at 1.) In
 14 Washington (as in other states), "[a] material breach suspends the
 15 injured party's duties until the breaching party cures the default."
 16 *Bailie Comm., Ltd. v. Trend Business Systems*, 53 Wn. App. 77, 81, 765

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 18 ³"The term 'ultra vires' . . . is used to describe corporate
 19 transactions which are outside the objects for which the
 20 corporation was created[.]" *Twisp Mining & Smelting Co. v.*
 21 *Chelan Mining Co.*, 16 Wn.2d 264, 293-94, 133 P.2d 300 (1943).
 22 Given the purposes for which the SRSC was incorporated, and the
 23 powers with which it is endowed, an argument can be made that the
 24 SRSC has authority to regulate the number of acres of sugarbeets
 25 that its members may plant. Granted, Section 3 of Article IV may
 26 limit the SRSC's authority. *But see supra* note 1. Nevertheless,
 the existence of a limit on the SRSC's authority does not
 necessarily mean that the Board's acreage reductions were ultra
 vires. *Cf. Hartstene Pointe Maintenance Ass'n v. Diehl*, 95 Wn.
 App. 339, 345, 979 P.2d 854 (1999) (distinguishing between a
 challenge to the existence of corporate authority and a challenge
 to the manner in which a corporation exercises its authority).

1 P.2d 339 (1988) (citing *Restatement (Second) of Contracts* §§ 237, 241
 2 (1981)).⁴ Consequently, if the Board's acreage reductions materially
 3 breached the relevant Grower Agreements, the plaintiffs may have been
 4 relieved of their duty to plant sugarbeets.

5 Whether a breach is material is a question of fact. *TMT Bear*
 6 *Creek Shopping Ctr., Inc. v. PETCO Animal Supplies, Inc.*, 140 Wn. App.
 7 191, 209, 165 P.3d 1271 (2007). Section 241 of the *Restatement* lists
 8 five circumstances that are relevant to a determination of
 9 materiality:

10 (a) the extent to which the injured party will be
 11 deprived of the benefit which he reasonably expected;

12 (b) the extent to which the injured party can be
 13 adequately compensated for the part of that benefit of which
 14 he will be deprived;

15 (c) the extent to which the party failing to perform or
 16 to offer to perform will suffer forfeiture;

17 (d) the likelihood that the party failing to perform or
 18 to offer to perform will cure his failure, taking account of
 19 all the circumstances including any reasonable assurances;

20 (e) the extent to which the behavior of the party
 21 failing to perform or to offer to perform comports with
 22 standards of good faith and fair dealing.

23 *Restatement, supra*, § 241.⁵

24 ⁴The Grower Agreement contains a choice of law clause. The
 25 Court need not decide whether the clause is effective unless
 26 there is an actual conflict between Washington and Idaho law.
Erwin, 161 Wn.2d at 692. Although the Idaho Supreme Court may
 not have adopted sections 237 and 241, it is well established
 that "one cannot declare a forfeiture of a contract where he
 himself is materially in default." *Barnard & Sons, Inc. v.*
Akins, 109 Idaho 466, 708 P.2d 871 (1985).

⁵The Washington Court of Appeals has approved use of the
 above-quoted factors. *TMT Bear Creek Shopping Ctr., Inc.*, 140
 Wn. App. at 209 and n.8.

1 The parties disagree with respect to whether the 2004 and 2005
2 acreage reductions deprived the plaintiffs of benefits. The
3 plaintiffs point out that they were not allowed to plant one acre of
4 sugarbeets for each share of Patron Preferred Stock they held. In
5 response, the defendants submit that the acreage reduction was
6 necessary to keep the SRSC operating profitably.

7 Assuming, for purposes of argument, that the acreage reductions
8 deprived the plaintiffs of benefits, their loss was small when
9 compared to the payments which they received from the SRSC for the
10 sugarbeets they delivered. Furthermore, the plaintiffs may bring an
11 action for damages to recover any benefits they lost as a result of
12 the SRSC's alleged breach. A damage award should fully compensate
13 them.

14 "A material failure by one party gives the other party the right
15 to withhold further performance as a means of securing his expectation
16 of an exchange of performances." *Restatement, supra*, § 241, comment
17 e, at 241. The plaintiffs planted sugarbeets during 2004 despite the
18 Board's decision to impose a 5% acreage reduction. The SRSC paid the
19 plaintiffs for the sugarbeets they delivered. There is no evidence
20 that, as the 2005 planting season approached, the plaintiffs thought
21 that the SRSC was breaching the Grower Agreements by limiting
22 production. Nor is there any evidence that the plaintiffs refrained
23 from planting sugarbeets during 2005 in order to secure their
24 expectations under the Grower Agreements. To the contrary, it is
25 undisputed that their decision to refrain from planting was based upon
26 entirely unrelated considerations. Furthermore, if the plaintiffs had
planted sugarbeets during 2005, there is every reason to think the
SRSC would have paid them for the sugarbeets they delivered. In other

1 words, the plaintiffs' expectations under their respective Grower
2 Agreements were reasonably secure during 2005 despite the acreage
3 reductions. The plaintiffs failure to plant during 2005 did not
4 increase their security. If anything, it undermined their security.
5 See *id.* ("To the extent that [the injured party's] expectation is
6 already reasonably secure, in spite of the failure [of the breaching
7 party to perform], there is less reason to conclude that the
8 [breaching party's] failure is material.").

9 The final circumstance is the presence or absence of good faith
10 or fair dealing. Although a party to a contract may, in good faith,
11 fail to perform a duty and breach the agreement, "[t]he extent to
12 which the behavior of the party failing to perform . . . comports with
13 standards of good faith and fair dealing is . . . a significant
14 circumstance in determining whether the failure is material."
15 *Restatement, supra*, § 241, comment f, at 241-42. The Board claims it
16 imposed acreage reductions in an effort to maintain the financial
17 health of the Cooperative. Moreover, the Board did not single out the
18 plaintiffs; the reductions applied to all SRSC sugarbeet growers.

19 No one of the preceding factors is dispositive in determining
20 whether the SRSC's alleged breaches of the Grower Agreements were
21 material. Upon weighing all of the factors, a rational jury could
22 find that the SRSC's alleged breaches were not material. By way of
23 illustration only, the jury might be persuaded by evidence that,
24 during 2004 and 2005, the plaintiffs did not perceive the acreage
25 reductions as breaches of contract; did not think that the reductions
26 threatened their expectations under the Grower Agreements; and did not
refrain from planting in order to secure performance by the SRSC. It
follows that the plaintiffs are not entitled to summary judgment on

1 this issue.⁶

2 C. Liquidated Damages

3 The parties agree that paragraph 8 of the Grower Agreements --
 4 i.e., the share-forfeiture provision -- is a liquidated damages
 5 clause. The Washington Supreme Court has adopted a two-part test "to
 6 determine whether a liquidated damages clause is enforceable. First,
 7 the amount fixed must be a reasonable forecast of just compensation
 8 for the harm that is caused by the breach. Second, the harm must be
 9 such that it is incapable or very difficult of ascertainment." *Walter*
 10 *Implement, Inc. v. Focht*, 107 Wn.2d 553, 559, 730 P.2d 1340 (1987)
 11 (citations omitted). The preceding test is applied as of the time the
 12 parties formed the contract. *Watson v. Ingram*, 124 Wn.2d 845, 851,
 13 881 P.2d 247 (1994). In other words, it is a "prospective" test. *Id.*
 at 850.

14 The liquidated-damages test adopted by the Idaho Supreme Court
 15 differs in at least one important respect. In Idaho, "parties to a
 16 contract may agree upon liquidated damages in anticipation of a
 17 breach, in any case where the circumstances are such that accurate
 18 determination of the damages would be difficult or impossible, and
 19 provided that the liquidated damages fixed by the contract **bear a**
 20 **reasonable relation to actual damages.**" *Graves v. Cupic*, 75 Idaho
 21 451, 456, 272 P.2d 1020, 1023 (1954) (emphasis added). By considering
 22 the non-breaching party's actual damages, the Idaho test is at least
 23 partially retrospective in nature. See *Watson*, 124 Wn.2d at 850 ("The
 24 question before this court is whether this test is to be applied as of

25 ⁶Even viewing the evidence in the light most favorable to
 26 the plaintiffs, it is difficult to see how a rational could find
 that the SRSC's alleged breaches were material.

1 the time of contract formation (prospectively) or as of the time of
2 trial (retrospectively).").

3 The parties have not addressed the apparent conflict between
4 Washington and Idaho law. They simply assume that the choice-of-law
5 clause in the Grower Agreements governs; and they may be correct.
6 *Erwin*, 161 Wn.2d at 694-700. In any event, since neither side
7 contests the application of Idaho law, the Court will employ the
8 *Graves* test.

9 The plaintiffs bear the burden of proving that the forfeiture
10 provision in paragraph 8 is unenforceable. *Magic Valley Truck*
11 *Brokers, Inc. v. Meyer*, 133 Idaho 110, 117, 982 P.2d 945, 951
12 (Ct.App.1999). They do not appear to dispute that, when they executed
13 their respective Grower Agreements, an accurate determination of
14 damages would have been difficult. Instead, the plaintiffs focus on
15 the second prong of the *Graves* test; arguing that the forfeiture of
16 their shares of Patron Preferred Stock does not bear a reasonable
17 relationship to the damages that the SRSC actually sustained as a
18 result of their failure to grow sugarbeets during 2005 and 2006.⁷

19 The plaintiffs submit that the price which they paid for their
20 shares of Patron Preferred Stock -- \$400.00 per share -- represents
21 the shares' minimum value. In the plaintiffs' opinion, the value of
22 their shares vastly exceeds the SRSC's actual damages. As they point

23 ⁷It is questionable whether the plaintiffs could make this
24 argument under Washington law. See *Watson*, 124 Wn.2d at 851
25 ("The prospective approach concentrates on whether the liquidated
26 sum represents a reasonable prediction of the harm to the seller
if the buyer breaches the agreement, and ignores actual damages
except as evidence of the reasonableness of the estimate of
potential damage.").

1 out, one share of Patron Preferred Stock represents one acre of
2 sugarbeets. (Grower Agreement at 1 (an SRSC member has a right to
3 grow "one (1) acre of sugarbeets per share [of Patron Preferred
4 Stock]").) The Board demanded \$75.00 for each acre of sugarbeets that
5 they did not plant. Thus, according to the plaintiffs, the SRSC's
6 actual damages are \$75.00 per share. If the values proposed by the
7 plaintiffs are reasonably accurate, the SRSC has reaped an enormous
8 windfall by forfeiting the plaintiffs shares of Patron Preferred
9 Stock.

10 The SRSC challenges both of the assumptions upon which the
11 plaintiffs' argument is based. To begin with, the SRSC submits that
12 the price which the plaintiffs paid for their shares of Patron
13 Preferred Stock was an arbitrary number. In the SRSC's opinion, the
14 \$400.00-per-share figure does not represent the actual value of the
15 shares at the time of purchase. Rather, according to the SRSC, the
16 figure is simply the price the plaintiffs had to pay for the privilege
17 of joining the SRSC and obtaining the benefits that membership
18 conferred. Furthermore, the SRSC argues that its actual damages are
19 substantially more than the \$75.00 per acre it demanded as a make-
20 whole payment. That figure, says the SRSC, is hundreds of dollars
21 less per share than the damages the Cooperative actually sustained as
22 a result of the plaintiffs failure to grow sugarbeets during 2005 and
23 2006. The SRSC argues that more realistic damage figures are \$465 per
24 share for 2005 and \$554 per share for 2006.

25 It is true, as the SRSC argues, that the valuation evidence
26 presented by the plaintiffs is far from overwhelming. They are not
entitled to summary judgment as the record now stands. Nevertheless,
the fact that the SRSC sold Patron Preferred Stock for \$400 per share

1 is some evidence of the shares' value. Similarly, the fact that the
2 SRSC demanded \$75.00 per acre as a make-whole payment is some evidence
3 of the Cooperative's actual damages. The SRSC vigorously disputes the
4 validity of the plaintiffs' valuation evidence, and the SRSC has
5 submitted valuation evidence of its own. The dispute between the
6 parties is material to the outcome of the case. If the plaintiffs are
7 correct, the liquidated damages clause is unenforceable. If the SRSC
8 is correct, not only is the clause enforceable, but the plaintiffs
9 have benefitted financially from forfeiture, as opposed to paying
10 damages. In order to resolve the dispute, the Court must make
11 credibility determinations. It would be inappropriate for the Court
12 to attempt to do so on a "paper" record. An evidentiary hearing or
13 trial is necessary.

14 **PLAINTIFFS' CONVERSION CLAIM**

15 The plaintiffs' fourth cause of action is a claim for conversion.
16 They allege that the SRSC wrongfully forfeited their shares of Patron
17 Preferred Stock under paragraph 8 of the Grower Agreements. In
18 essence, this is the mirror image of the counterclaim discussed in the
19 preceding section. For the same reasons that the Court cannot grant
20 the plaintiffs' motion for summary judgment on the defendants'
21 counterclaim, the Court cannot grant the defendant's motion for
22 summary judgment on the plaintiffs' conversion claim.

23 **TENTATIVE CONCLUSIONS**

24 1. The plaintiffs may not assert the ultra vires doctrine as a
25 shield to the SRSC's enforcement of paragraph 8 of the Grower
26 Agreements.

2. Genuine issues of material fact exist with respect to whether
the SRSC's 2004 and 2005 acreage reductions constitute material,

1 antecedent breaches of the Grower Agreements.

2 3. Genuine issues of material fact exist with respect to both the
3 value of the plaintiffs' shares of Patron Preferred Stock and the
4 extent of the SRSC's actual damages as a result of the plaintiffs'
5 failure to grow sugarbeets during 2005 and 2006.

6 **CONCLUSIONS ARE TENTATIVE**

7 The conclusions set forth above are tentative. After listening
8 to oral argument, the Court may modify or abandon some or all of them.
9 Since this is not an order, the Court will not consider a motion for
10 reconsideration. Nor will the Court consider supplemental evidence or
11 memoranda. The record is complete for purposes of dispositive
12 motions.

13 **THE DISTRICT COURT EXECUTIVE** is hereby directed to enter the
14 Court's tentative conclusions and furnish copies to counsel.

15 **DATED** this 21st day of July, 2008.

16 s/Fred Van Sickle
17 Fred Van Sickle
18 Senior United States District Judge
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